

REDACTED PUBLIC VERSION

**ILLINOIS COMMERCE COMMISSION
DATA REQUEST**

REQUEST NUMBER SDR-020

Utility Company: MidAmerican Energy Company

Docket No.: 02-0173

Date of Response: April 29, 2002

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- SDR-020 This request pertains to the Company's audits of its purchasing and contracting decisions for MGP environmental cleanup costs.
- a. How often are the MGP environmental cleanup purchasing and contracting functions audited by management using internal or external auditors?
 - b. Provide the dates when the three most recent audits were conducted and provide copies of those audit reports.
 - c. List and explain any changes or modifications made to the purchasing and contracting decision-making process as a result of these audits.

Response:

- a. Typically the frequency of internal audits is related to the perceived risk relating to one subject as compared to other risks throughout the Company. Internal Audits for manufactured gas remediation are generally done each 3 to 5 years. Deloitte and Touche, our external auditor since 1999, has not performed a purchase and contracting audit, specifically relating manufactured gas remediation.
- b. The two most recent internal audits were completed in July 1996 and March of 2001. See Confidential Attachment SDR-020(a) and Attachment SDR-020(b).
- c. Refer to the "action" section within each audit.



CONFIDENTIAL

Internal Audit Report

MANUFACTURED GAS PLANT CLEANUP COSTS

Submitted by J. T. Kinning
March 2001

INTERNAL AUDIT REPORT

Manufactured Gas Plant Cleanup Costs

Submitted by J.V. Rogers

July 1996

SCOPE

An audit of former manufactured gas plant (MGP) cleanup costs was completed in July 1996. The objective of the audit was to determine if costs were adequately controlled, authorized and properly accounted for. The review was limited to those incurred over the previous twelve months at three sites where remedial action is currently being carried out.

BACKGROUND

Beginning around 1850, gas was manufactured from coal to provide street lighting as an alternative to electricity. More than one thousand plants were built across the country where gas was derived from coal and oil. Coal tar residue was produced which contains toxic chemicals such as cyanide and phenols. Manufactured gas plant cleanup may be necessary because groundwater contamination could occur from residue and contaminants left at the sites. Liability can be imposed on those considered to be potentially responsible parties. These can include:

- current or past owners of a facility,
- owners or operators of the facility at the time of the release of the toxic substances,
- those who arranged for disposal of the substances,
- those who accepted or transported the material or
- those who dismantled the facility.

Cleanup regulations are specified by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund) and the Resource Conservation and Recovery Act (RCRA). Cleanup is directed by the Environmental Protection Agency (EPA) and the state, which dictates work and imposes deadlines for completion. The EPA also requires regular reporting of accomplished and upcoming work. MidAmerican Energy Company (MEC) is subject to penalties if the EPA's scheduling and reporting requirements are not met.

There are twenty-nine sites where the Company may face liability. Two sites have been completed. Three sites where excavation is in progress are Dubuque People's Natural Gas (PNG), Waterloo Coal Plant and Moline. Since 1989, total costs incurred in manufactured gas plant cleanup are approximately \$28 million. An additional \$21 million has been recorded as a liability. The recorded liability is an estimate based on preliminary investigations currently completed. As future investigations are completed, the liability may increase.

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The manner in which costs are recovered through rates differs for Iowa and Illinois. Iowa allows a flat amount to be recovered each year based on the latest rate case. This amount is approximately \$4.1 million per year for MEC West and \$250,000 for MEC East. Illinois allows recovery via a rider to rates. A provision is made to reconcile amounts collected with actual cost.

Audit Results

In general, MGP remediation is well managed. The Company has taken a pro-active position, investigating sites and planning remediation before being ordered to do so by the EPA. In the long run this will be less costly because legal and other fees imposed by the EPA may be avoided. Statistics indicate that sites under the jurisdiction of the EPA average about 15 years and \$35 million to remediate. Sites under the jurisdiction of the Iowa Department of Natural Resources can be completed much more quickly and often for less than \$2 million. Except for the issues noted below, costs are adequately controlled, authorized and properly accounted for.

Sales/Use Tax

Omissions in accrual of sales/use taxes have occurred for work performed at remediation sites.

Sales/use tax issues can be complex and differ between Iowa and Illinois. Vendors without a physical presence in the state are not required to collect the tax, leaving the burden on the purchaser. Likewise, the purchaser is ultimately liable for the tax when it is not collected by the in-state vendor. The Company can be assessed the tax, interest and penalties if omissions are discovered in a tax audit.

Iowa taxes materials and some services. Pertaining to MGP cleanup, rental of excavating equipment and labor for machine operators are taxable. Illinois generally taxes materials but not services.

The Accounts Payable Department accrues tax on vouchers as they are processed for payment. The amounts owed are added to the project cost. Payment is remitted to the state quarterly. Omissions can occur when Accounts Payable is not aware that certain transactions are taxable.

Internal Audit noted two vendors for which proper accruals were not made.

- An Illinois company provides equipment and labor, both taxable, at two Iowa sites. Tax has not been consistently accrued on these invoices. The estimated liability to the Company is \$7,500.
- An Iowa company has provided soil, rock and other materials as backfill at the Moline excavation. No tax has been remitted to Illinois. The estimated liability is less than \$5,000.

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Recommendations:

- 1.) The Manufactured Gas Plant Remediation Department should work with the Accounts Payable and Tax Departments to ensure that tax is recorded and remitted on vouchers previously paid.
- 2.) For future projects, the Manufactured Gas Plant Remediation Department should consult with the Tax and Purchasing Departments to identify taxable transactions. These should be noted on the purchase order. When submitting an invoice to Accounts Payable, the project manager should identify taxable items. Accounts Payable should refer to the purchase order to verify the taxable items are correct.

Action:

Management agrees with the recommendations. Past taxable transactions will be identified and tax will be paid. Procedures will be established to identify taxable transactions on future activities. These will be completed by the end of the third quarter of 1996.

Purchase Orders and Contracts

- 1.) Changes in work scope are not adequately noted on purchase orders and contracts.

Separate purchase orders were set up for two different companies. Barr Engineering provided engineering services and Groundwater Technology (GTI) provided excavation services at both the Waterloo and Dubuque PNG sites. During the course of the project, it was learned that GTI could provide superior site engineering services displacing some of Barr's.

GTI submitted separate fee schedules for excavating and other professional services. All these costs were charged to the purchase order that had been set up for excavation services only. A single contract that was originally intended for excavation services at Waterloo only was now referenced for excavation, engineering, consulting and other professional services at both Waterloo and Dubuque PNG. A review of invoices could not determine which charges were for excavation and which were for professional services. Discrepancies were noted between what was charged on invoices and what was allowed by contract.

Representatives of the Internal Audit and MGP Departments met with GTI management to resolve these discrepancies. A refund to MEC of approximately \$20,000 was negotiated. Allowable charges were clearly defined so that accurate billings can be made for the balance of the contract.

- 2.) Accurate reporting is necessary both for rate regulation and to satisfy EPA and the Iowa Department of Natural Resources requirements. Sub-project numbers have been established to

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separately quantify costs. Some categories to track field work include:

- investigation
- remediation
- disposal/destruction
- follow-up
- lab fees

This mixing of work on the purchase orders and contracts may cause costs and services to be misclassified.

Recommendations:

- 1.) Items charged to a particular purchase order should be directly related to it's intent. Additional unrelated work should be separately invoiced and clearly distinguished in a change order or charged to a new purchase order.
- 2.) Contracts should clearly state the nature of the work to be performed. If additional work is found to be needed, it should be specified in an addendum or a separate contract.

Action:

MGP management agrees with the recommendations. A resolution concerning contracts and purchase orders addressing these issues will be written and distributed to all MGP staff. This will be completed by the end of September 1996.